

STATE OF VERMONT
PUBLIC SERVICE BOARD

Docket No. 7565

Petition of Town of Stowe Electric Department)
Pursuant to 30 V.S.A. § 108(c) for Approval to)
Finance the Acquisition of Vermont Transco, LLC,)
Membership Units)

Order entered: 10/28/2009

I. INTRODUCTION

On September 18, 2009, the Town of Stowe Electric Department ("Stowe" or "the Company") filed a petition (the "Petition") with the Vermont Public Service Board ("Board") for approval pursuant to 30 V.S.A. § 108(c) to issue \$1.1 million in long-term debt ("Member Unit Financing" or "bank loan") to finance the purchase of its 2009 allocated share of Class A and Class B units ("Member Units")¹ in Vermont Transco LLC ("Transco"). The Member Units consist of "make-up" equity and load-ratio-share equity related to construction of the 115 kV Lamoille County Project ("LCP" or "Project").² Stowe plans to finance the purchase with a taxable bank loan provided by Union Bank ("Union"). The Petition was supported by the testimony of Patrick Householder, Controller for Stowe, and by accompanying exhibits.

On October 1, 2009, the Clerk of the Board issued a letter informing Stowe that additional financial information in the form of Stowe's audited statements for fiscal year 2008 and internally generated financial statements for the third quarter ending September 30, 2009, was needed in order to complete the review of the Petition.

1. Equity units are generally referred to as "member units" in the Operating Agreement for Vermont Transco, LLC.

2. The Lamoille County Project received a Certificate of Public Good from the Board in Docket No. 7032 on March 16, 2006. LCP members consist of Stowe, Town of Hardwick Electric Department, Village of Hyde Park Electric Department, Village of Johnson Water & Light Department, and Village of Morrisville Water & Light Department. Non-municipal participants in the Project are Green Mountain Power Corporation, Central Vermont Public Service Corporation, and Washington Electric Cooperative, Inc.

On October 5, 2009, Stowe filed the additional financial information except for the September, 2009, quarterly statements. In its cover letter, Stowe explained that the September, 2009, quarterly statements would not be available until November 1, 2009, and submitted its June, 2009, second quarter statements instead.

On October 15, 2009, the Vermont Department of Public Service ("DPS") sent a letter with attached Determination Under 30 V.S.A. § 202(f) to the Board recommending that the Board approve the Petition without hearing and finding that the issuance of long-term debt as set forth in the Petition is consistent with the *Vermont Electric Plan* pursuant to 30 V.S.A. § 202(f).

On October 16, 2009, the DPS submitted a letter to the Board stating that it believes that the Petition is consistent with the general good of the state, and recommending approval of the Petition without a hearing.

I have reviewed the Petition, the supporting testimony, and accompanying documents. I conclude that approval of Stowe's Petition pursuant to 30 V.S.A. § 108(c) is appropriate and that such approval may occur without hearing. Based upon the evidence of record and the testimony and exhibits presented in this docket, and the DPS letters of October 15 and 16, 2009, I hereby report the following findings and conclusion to the Board in accordance with 30 V.S.A. § 8.

II. FINDINGS

1. Stowe is a company as defined by 30 V.S.A. § 201, and a municipal electric utility within the meaning of 30 V.S.A. Chapters 14 and 79. Petition at 1.

2. Transco has received Board approval to issue membership units in Transco to Vermont distribution companies primarily in accordance with their respective "load ratio shares."³ Petition at 1.

3. Transco is preparing to offer additional membership units for 2009. Stowe plans to purchase its full allotment of the 2009 equity issuance as determined by its share of Vermont load. Stowe's allocated share of the 2009 equity is estimated to total \$1,035,700, consisting of \$517,540 of "make-up" equity and \$518,160 of load-ratio-share equity. "Make-up" equity represents Transco equity that was allocated to Stowe in the past but which Stowe was not able to

3. See Docket No. 7310.

purchase at the time of the initial offering.⁴ Stowe is now being given an opportunity to purchase that equity so as to equalize its ownership share in Transco with its load-ratio share.

Householder pf. at 3.

4. The ratio of Class A and Class B units will be determined by Transco; however, if it is the same as the 2008 equity issuance, it will be 44% of the Class A units and 56% of the Class B units. Class A units pay a dividend rate of 11.50% and Class B units, which can only be owned by municipal utilities, pay a dividend rate of 13.50%. Stowe's blended dividend rate, assuming the 44/56 ratio of Class A and Class B units, will be 12.5%. *Id.*

5. Stowe has received a commitment from Union to provide the Member Unit Financing with a \$1.1 million bank loan at a taxable fixed rate of interest of 6.5%. The loan term is for ten years with a twenty-year amortization. Union has committed to renew the loan after ten years for an additional ten years, but with an adjustment to the interest rate depending on market conditions in existence at that time. Householder pf. at 4; exh. Stowe-Householder-2.

6. Stowe estimates that the arbitrage spread between the anticipated blended dividend rate of 12.5% and the rate of interest on the bank loan of 6.5% will be sufficient to cover principal and interest payments during the initial ten-year term and still provide a net annual return of approximately 3% (\$35,000) to mitigate transmission costs for the benefit of ratepayers. Householder pf. at 3.

7. The Town of Stowe has warned a public meeting for November 3, 2009, to vote on the proposed Member Unit Financing. Householder pf. at 4.

III. DISCUSSION & CONCLUSION

Based on the evidence outlined above, I recommend Board approval of Stowe's financing request, but not without continuing reservations regarding Stowe's financial condition as explained below. Stowe's current request for \$1.1 million in long-term debt financing to purchase its 2009 allocated share of Class A and Class B Member Units from Transco will allow Stowe to purchase its full allotment of the equity issuance and will not place an additional financial burden on Stowe since the cash distributions from the Member Units will be sufficient

4. See Docket No. 7310, Order of 10/15/08 at 7, for an explanation of Transco's "make-up" equity purchase arrangement with the LCP participants.

to cover the related debt-service. Therefore, I find that approval of Stowe's request for long-term indebtedness in an amount not to exceed \$1.1 million as described in the findings above is consistent with the general good of the state and recommend that the Board issue an order to that effect.

In the Board's Order of October 30, 2008, in Docket 7458, I outlined concerns involving Stowe's increasing debt load, constricted cash flow, and future ability to borrow especially in the event of a contingency.⁵ Unfortunately, after reviewing Stowe's audited 2008 financial statements and its internal financial report for the second quarter 2009 that were submitted in this proceeding, these concerns persist, and additional concerns have arisen.

In fiscal 2008, Stowe incurred a sizable liability in the amount of \$1.6 million consisting mostly of legal expenses related to litigating the costs of the LCP. Stowe had initially sought Board approval to amortize those expenses as part of the Project, but the Board denied Stowe's request on September 18, 2008, finding that the costs did not qualify as a deferrable regulatory asset.⁶ As a result of the Board's denial, Stowe charged the expense to its \$1.7 million line of credit and subsequently paid off that amount in late 2008 with funding provided by a short-term bond anticipation note in the amount of \$1.6 million.⁷ With the addition of this \$1.6 million in new debt, combined with the 2008 financing for the purchase of Transco Member Units in the amount of \$18.7 million, Stowe's debt-to-equity ratio significantly increased from 0.68:1 in 2007 to 6:1 in 2008.⁸ In addition, the issuance of General Obligation Bonds ("GOB") in the amount of \$4.0 million, also approved by the Board in Docket 7458, will increase this ratio to an estimated 6.38:1 in fiscal year 2009.⁹ Stowe recently used a portion of those bond proceeds to pay off the short-term bond anticipation note of \$1.6 million.¹⁰

5. Docket No. 7458, Order dated 10/30/08 at 8-9.

6. *See* Stowe Accounting Order dated 9/18/08 at 5.

7. Town of Stowe, VT Electric Department, 2008 Financial Statements (Audited), "Management's Discussion and Analysis."

8. Town of Stowe, VT Electric Department, 2008 Financial Statements (Audited) at 1.

9. The issuance of the \$4.0 million in General Obligation Bonds took place in July, 2009, and was used in part to refinance the \$1.6 million bond anticipation note (the Hearing Officer's estimated 2009 debt-to-equity calculation takes this into account). Stowe e-mail dated 10/22/09.

10. Stowe e-mail dated 10/22/09.

In conjunction with Stowe's additional debt load, Stowe's constricted cash flow position also continues to be a concern. In 2008, Stowe reported negative net operating cash flow of -\$1.8 million and negative net income of -\$1.6 million.¹¹ Even after compensating for the one-time expense of \$1.6 million related to the LCP litigation costs, operating cash flow still would have been in the negative at -\$247,475. Likewise, net income for 2008 still would have been negative at -\$28,949 due to increased operating expenses of \$213,659.¹² Since positive operating cash flows are necessary in order to meet debt servicing obligations, it appears that Stowe had to meet those obligations (\$68,299 in principal and interest), along with regular annual capital expenditures, through a combination of borrowings and utilization of its cash reserves. Stowe's free cash flow¹³ was also in the negative in 2008, as demonstrated by the decline in Stowe's available unrestricted cash reserves from 2007 to 2008 in the amount of -\$173,816.¹⁴ Since it is common knowledge that Vermont utilities, as well as national utilities, are experiencing either flat or declining gross revenues for 2009 due to recessionary pressures on consumer demand and load growth, an extended recessionary period could prove to be problematic for Stowe.

Additionally, although it is understood that the debt service for the Member Unit Financing, including the \$18.7 million approved in Docket No. 7458, will be covered by the cash distributions from the Member Units, Stowe has other upcoming obligations which will have to be funded out of operating cash flow. For example, debt service on the GOB, totaling \$235,000 annually (principal and interest), is scheduled to begin during the 2009-2010 time frame.¹⁵ Also, during the same time period, Stowe has an upcoming annual expenditure of \$1.1 million for Specific Facilities charges related to the LCP, of which Stowe will pay a net amount of \$460,000,

11. Town of Stowe, VT Electric Department, 2008 Financial Statements (Audited) at 2, 3.

12. *Id.*

13. "Free cash flow" refers to cash provided by operating activities less replacement capital expenditures and any required principal payments on debt. Free cash flow is designed to measure cash available to a firm for discretionary uses after all required cash payments have been made. Comiskey, E. and C. Mulford, 2000, *Guide to Financial Reporting And Analysis*, New York: John Wiley & Sons, 604.

14. Town of Stowe, VT Electric Department, 2008 Financial Statements (Audited) at 1.

15. Docket No. 7458, Order dated 10/30/08 at 5.

that it proposes to fund out of operating cash flows.¹⁶ Although Stowe received Board approval for an 8.71% rate increase on March 27, 2009,¹⁷ and Stowe will also receive \$605,000 from the pending sale of an interest-rate swap related to the refinancing of its existing \$18.7 million member unit financing,¹⁸ it is not known at this time whether these mitigating factors are sufficient to compensate for the cash flow concerns outlined above.

Lastly, additional concerns are raised by the diversion of \$1.6 million in proceeds from the \$4.2 million GOB financing (approved in Docket No. 7458) to essentially pay off debt incurred as a result of the legal costs of the LCP litigation. Under Stowe's Stipulation ("Stipulation") with the DPS in that docket dated October 20, 2008, and Condition No. 3 of the Board's Order of October 30, 2008, Stowe was specifically required to earmark the GOB proceeds as follows: (1) dedicate \$1.6 million to fund its obligations for "Exclusive Facilities" costs as required under the Settlement; and (2) dedicate the remaining balance of \$2.4 million to fund capital improvements projects for upgrading Stowe's overall distribution system.¹⁹ In light of these requirements, it appears that Stowe's use of the \$1.6 million to cover the refinancing of its LCP legal expenses does not comply with the requirements of the Board's Order and the DPS Stipulation, and thus may constitute a violation of Condition No. 3 of the Board's Order in Docket No. 7458.

The parties have waived their rights to file exceptions and present arguments under 3 V.S.A. § 811. Therefore, the proposal for decision has not been served on the parties.

Dated at Montpelier, Vermont this 28th day of October, 2009.

s/Jay E. Dudley
Jay E. Dudley
Hearing Officer

16. *Id.* Under the terms of the Settlement, Stowe's annual obligation for the Specific Facilities costs is \$1.1 million. This obligation was to be offset by avoided annual sub-transmission fees and avoided sub-transmission line losses that Stowe will no longer incur because of its direct connection to the LCP's 115 kV transmission line. Because of these avoided costs, Stowe's net annual Specific Facilities obligation was estimated to be \$460,000.

17. Tariff No. 8077, dated 3/27/09.

18. Docket No. 7566, Order dated 10/28/09 at 3.

19. Docket No. 7458, Order dated 10/30/08 at 5, 8-9.

IV. BOARD DISCUSSION

We accept and adopt the Hearing Officer's findings, recommendations, and conclusion, and likewise share his concerns regarding Stowe's increasing debt levels and its ability to service debt obligations which are not offset by the cash distributions provided by the Membership Units. We are especially concerned regarding Stowe's recent refinancing, with restricted funding provided by the GOB, of its \$1.6 million bank note which largely represents the litigation costs related to the LCP. As outlined above in our Order in Docket 7458 dated October 30, 2008, our approval of that financing request was based and conditioned on the Stipulation reached between the DPS and Stowe that the funds provided by the GOB would be specifically earmarked for capital improvements and Exclusive Facilities charges. In addition, in a prior Order issued on September 18, 2008, we denied Stowe's request for an accounting order to allow the deferral of the LCP litigation costs as a regulatory asset, finding that such costs were not extraordinary and therefore not recoverable in rates. Stowe's application of the GOB funds towards the LCP litigation costs appears to indicate an attempt by Stowe to circumvent the intent and spirit of both Orders since GOB funds were apparently diverted for purposes other than those required in Docket 7458, and the interest charges on those funds would normally be recoverable in rates if that funding had been applied as stipulated to cover the costs of the Exclusive Facilities and other capital projects.

In order for the Board to properly perform its function, it must rely upon representations made by the petitioner and the petitioner's future compliance with Board Orders. We thus are troubled by Stowe's apparent disregard for the Board's previous Orders as referenced in the Hearings Officer's discussion above, and therefore ask the parties to comment on these issues with particular attention given to the apparent violation of Condition No. 3 of the Board's Order in Docket No. 7458, and whether an investigation is warranted. All comments should be submitted to the Clerk of the Board by November 13, 2009.

V. ORDER

IT IS HEREBY ORDERED, ADJUDGED AND DECREED by the Public Service Board of the State of Vermont that:

1. The findings, conclusion and recommendation of the Hearing Officer are accepted and adopted.
2. The request for financing as set forth in the Town of Stowe Electric Department's ("Stowe") Petition in this docket, and as described in the Findings is consistent with the general good of the State of Vermont.
3. Pursuant to 30 V.S.A. §108(c), consent is hereby given to Stowe to issue long-term indebtedness to finance its purchase of its 2009 allocated share of Class A and Class B units in Vermont Transco, LLC, in an amount not to exceed \$1.1 million, according to terms and rate consistent with the Findings above.
4. This Order does not constitute approval of Stowe's capital structure or of any particular capital or operating expenditure that may be implemented with the proceeds from the issuance of long-term debt contemplated in the Petition in this docket. Nothing in this approval shall preclude the Vermont Department of Public Service ("DPS") or any other party, or the Vermont Public Service Board ("Board"), from reviewing or challenging such expenditures or Stowe's resulting capital structure.
5. Stowe shall provide the Board and the DPS with a complete set of final executed loan documents within 30 days of the loan closing.
6. Stowe shall inform the Board and the DPS of any material change in the terms and conditions of the financing, if any, prior to closing.

Dated at Montpelier, Vermont, this 28th day of October, 2009.

<u>s/James Volz</u>)	
)	PUBLIC SERVICE
)	
)	BOARD
)	
)	OF VERMONT
<u>s/John D. Burke</u>)	

OFFICE OF THE CLERK

FILED: October 28, 2009

ATTEST: s/Judith C. Whitney
Deputy Clerk of the Board

NOTICE TO READERS: This decision is subject to revision of technical errors. Readers are requested to notify the Clerk of the Board (by e-mail, telephone, or in writing) of any apparent errors, in order that any necessary corrections may be made. (E-mail address: psb.clerk@psb.state.vt.us)

Appeal of this decision to the Supreme Court of Vermont must be filed with the Clerk of the Board within thirty days. Appeal will not stay the effect of this Order, absent further Order by this Board or appropriate action by the Supreme Court of Vermont. Motions for reconsideration or stay, if any, must be filed with the Clerk of the Board within ten days of the date of this decision and order.